SUPREME COURT, U. S.

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No. 298

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1962.

CHARLES M. LAND, as Successor Executor of the Last Will and Testament of JOHN ROBERT LAND, Deceased,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

CHARLES M. LAND, ERNEST H. LAND, MARGARET L. HANEY, as Executors of the Last Will and Testament of ROBERT LAND, Deceased,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit.

JOHN E. ADAMS,
Grove Hill, Alabama,
Attorney for Petitioners.

C. B. GILLMORE,
JOHN E. ADAMS, JR.,
Of Counsel.

ST. LOUIS LAW PRINTING CO., INC., 415 N. Eighth Street. CEntral 1-4477.

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To the United States Court of Appeals for the Fifth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled case on May 16, 1962; there are two separate cases, based upon identical facts, which were consolidated in the District Court and thereafter treated and disposed of as if a single case, both in the District Court and in the Court of Appeals.

OPINIONS BELOW.

The opinion of the District Court is reported in 187 F. Supp. 521; petitioners are filing nine copies of the record

as printed for the use of the court below, and the opinion of the District Court appears at pages 55-67 therein. The opinion of the Court of Appeals (R. 113-123), printed in Appendix A, infra, p. 46, is reported in ... F. 2d ... (Decided May 16, 1962 and not yet reported).

JURISDICTION.

The judgment of the Court of Appeals was entered on May 16, 1962 (R. 124-5). No application for rehearing was filed. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1), 62 Stat. 928.

QUESTION PRESENTED.

Where the partnership interest of a deceased partner was subject to a restrictive price agreement under which no partner could sell his interest to an outsider, but if such partner had desired to withdraw during his lifetime, the other partners had an option to purchase the interest of the retiring partner at two-thirds of its fair market value, and in event of death of a partner the surviving partners had an option to buy the interest of the deceased partner at full value, should the partnership interest be valued for estate tax purposes at two-thirds of market value, or at full market value?

Or, stated differently, is the estate tax measured by the value of the interest of the decedent which ceased by reason of the death, or by the value of the interest to which the devisees succeeded?

STATUTES INVOLVED.

The statutory provisions involved are those contained in the Internal Revenue Code of 1954, as follows:

Section 2001 (68A Stat. 373), Rate of Tax:

> A tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2051, of ev-

ery decedent, citizen or resident of the United States dying after the date of enactment of this title: (Table of rates omitted).

Section 2031 (a) (68A Stat. 380), Definition of Gross Estate:

(a) General.—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States

Section 2033 (68A Stat. 381), Property in which the Decedent had an Interest:

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

STATEMENT OF THE CASE.

The facts in both cases were all stipulated (R. 15-53 and R. 87-104), and are identical except that the amounts involved vary slightly; the facts may be summarized as follows:

Decedents, John Robert Land and his father, Robert Land, were, at the time of each of their deaths, members of a partnership known as Land Brothers & Company, composed originally of the father and his three sons (one of whom was John Robert Land) and two daughters. One of the sons, Ernest H. Land, had withdrawn from the partnership prior to the death of either decedent and his interest had been purchased by the other partners, pursuant to the partnership agreement.

John Robert Land died on January 5, 1955; the father, Robert Land, died on August 24, 1955. At the time of death of each decedent, there was in effect a partnership agreement (R. 25-28) stipulating in effect, among other things, that no partner was permitted to sell or encumber his or her separate interest in the partnership assets; that any partner could withdraw from the partnership at any time during his lifetime, but in event of such withdrawal, the other partners became vested with an option to purchase the interest of the withdrawing partner at two-thirds of fair market value. In event of death of a partner, the surviving partners became vested with an option to purchase the interest of the deceased partner at its full fair market value.

The bona fides of the partnership agreement was conceded by Government counsel, and it was stipulated (Par. 7, R. 17) that the agreement is valid and bona fide. Even without that stipulation, however, the bona fides of the agreement is apparent from the record. The entire net worth of the partnership when it was formed in 1939, with six owners, was only $198,943.70 (R. 33), so that the purpose of the agreement could not have been avoidance of estate taxes. The varied activities of the partnership (Par. 4, R. 34) disclose the necessity for the agreement that each partner devote full time to the business of the firm (Par. 5, R. 34); the married daughter was permitted to substitute her husband's services for her own. The difficulty of finding competent non-owner employees prompted the partners to incorporate the restrictive price option in event of voluntary withdrawal of a partner, to compensate for the loss of services of the withdrawing partner. It was not deemed appropriate to impose the discount in event of death of a partner.

In reporting the value of each decedent's partnership interest for estate tax purposes, the fair market value of

that interest was reduced by one-third, because of the restrictive agreement effective during the lifetime of the partner. Upon audit of each estate tax return, an estate tax deficiency was assessed against each estate, the Government contending that the partnership interest should have been included at full fair market value. The deficiency assessments were paid and claims for refund were duly filed, followed by suits in the District Court. The jurisdiction of the District Court was invoked under 28 U. S. C. 1346 (a) (R. 4).

The two suits were consolidated in the District Court by stipulation of the parties (R. 22, 94) and orders of the Court (R. 54, 105). Thereafter, they were handled and disposed of, both in the District Court and in the Court of Appeals, as a single case.

The District Court held that the taxpayers were entitled to relief; the Circuit Court of Appeals reversed.

REASONS FOR GRANTING THE WRIT.

The decision rendered here is in direct conflict with the decision in Lomb v. Sugden, 82 F. 2d 166, rendered March 2, 1936, in the Circuit Court of Appeals for the Second Circuit, involving the precise question presented here.

We think that it is also directly in conflict with the pronouncements of this Court in Knowlton v. Moore, 178 U. S. 41, Edwards v. Slocum, 264 U. S. 61, and Young Men's Christian Association v. Davis, 264 U. S. 47.

The precise question which is involved here has not been directly adjudicated by this Court. The three decisions of this Court which are cited above contain pronouncements which we think control the question and which were so interpreted and applied by the Court of Appeals for the Second Circuit in Lomb v. Sugden, supra:

but the decision here (in the Fifth Circuit) is directly in conflict therewith.

The question is whether the federal estate tax is measured by the value of the interest of the decedent which ceased by reason of the death, or whether it is measured by the value of the interest to which the devisees succeeded by reason of the death. In Knowlton v. Moore, supra, Mr. Justice White wrote a very scholarly opinion presenting the history of death duties, with a careful analysis of the distinction between estate duty or probate duty on the one hand and legacy or succession taxes on the other. In the United States we have had, at different times, both types of death duties; in fact, we have at times had both types existing concurrently. Our present estate tax originated in 1916 and now constitutes the only type of death duty which is imposed under our current Revenue Code. Mr. Justice White, in Knowlton v. Moore, supra, in speaking of the English "estate duty," which is analogous to our present estate tax, quoted from Hanson on Death Duties as follows:

> "The new duty imposed by the finance act, and called estate duty, as has been said above, supersedes probate duty; but the key to the construction of the finance act lies in remembering that the new estate duty, although it is leviable on property which was left untouched by probate duty, such as real estate, yet is in substance of the same nature as the old probate duty. What it takes is not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death. Unless this principle is kept clearly in view, the mind is constantly tempted by the wording of the act to revert to principles of succession duty which have no real connection with the subject."

After noting that our own statutes on this subject are quite obviously modeled after the English statutes, Mr. Justice White said further:

> "Indeed, the confusion which gives rise to both of the constructions of the statute which we have just considered comes from the want of insight pointed out by Hanson in a passage which we have heretofore quoted; that is, it arises from not keeping in mind the distinction between a tax on the interest to which some person succeeds on a death and a tax on the interest which ceased by reason of the death, the two being different objects of taxation."

In Edwards v. Slocum, 264 U. S. 61, this Court was construing the Act of February 24, 1919, which imposed a tax upon "the transfer of the net estate of every decedent dying after the passage of this act." The language of that statute is so nearly identical with that of our 1954 Revenue Code (Section 2001) that the same principles will obviously apply to both statutes. The case then before the court related to the estate of a Mrs. Sage. Mrs. Sage bequeathed sums amounting to $1,285,000 for charitable purposes, $8,618,079.55 for purposes other than charitable; and the residue to charitable and educational institutions named. In computing the tax, the executors claimed as exempt all of the charitable devises, including the residue in full, without reduction by reason of the estate tax although the estate tax was necessarily payable out of residue. The Government required the payment of an additional tax, reached by deducting from the exempt residue, before allowing the exemption, the amount of the tax to be paid, on the theory that the residuary legatees received only the net residue after payment of the estate tax. The executors paid the additional tax thus imposed and the suit was brought to recover such additional tax. This court, speaking through Mr. Justice Holmes, said:

"The government's argument turns largely upon the consideration that a residue is only what is left after the payment of paramount claims. But this is not a tax upon a residue; it is a tax upon a transfer of his net estate by a decedent—a distinction marked by the words that we have quoted from the statute, and previously commented upon at length in Knowlton v. Moore, 178 U. S. 41, 49, 77, 44 L. ed. 969, 973, 984, 20 Sup. Ct. Rep. 747. It comes into existence before, and is independent of, the receipt of the property by the legatee. It taxes, as Hanson, Death Duties, put it in a passage cited in 178 U. S. 49, 'not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death.' It levies a sum equal to a certain percentage of the value of the net estate, and provides the criteria by which the net estate shall be ascertained."

On the same day that the decision of Edwards v. Slocum was announced, this Court also decided Young Men's Christian Association v. Davis, 264 U. S. 47, construing the same statute (the Act of February 24, 1919) and its application to charitable bequests. Among other things, this Court, speaking through Mr. Chief Justice Taft said:

"What was being imposed here was an excise upon the transfer of an estate upon death of the owner. It was not a tax upon succession and receipt of benefits under the law or the will. It was death duties as distinguished from a legacy or succession tax. What this law taxes is not the interest to which the legatees and devisees succeeded on death, but the interest which ceased by reason of the death. Knowlton v. Moore, 178 U. S. 41, 48, 49, 44 L. ed. 969, 972, 973, 20 Sup. Ct. Rep. 747."

After Edwards v. Slocum, in Harrison v. Northern Trust Co. et al., 317 U. S. 476, this court was again considering a deduction from gross estate on account of a bequest to charity; this was subsequent to a 1932 amendment of the provision authorizing this deduction; under the amendment, the allowable deduction is expressly limited to the amount which passes to the charity after the deduction of estate taxes. This court expressly calls this amendment "a legislative reversal of the decision" in Edwards v. Slocum, supra, and quotes the House report as its authority for that statement. The court further comments on the fact that the granting of this exclusion rests entirely with Congress and it could have denied it altogether; instead, it chose merely to limit the charitable deductions. Congress can change the entire framework of the estate tax at its pleasure and to whatever extent it chooses, within constitutional limitations. Surely in considering the impact of Edwards v. Slocum on charitable bequests, it must have been conscious of the basic principles announced in Knowlton v. Moore, supra, as well as in Edwards v. Slocum, including the quotation from Hanson, expressly approved by the Court, that "it (the estate tax) taxes 'not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death,' " and Mr. Justice White's observation that the two constitute "different objects of taxation." Congress must have been aware, also, that in times past we have utilized both taxes, sometimes concurrently. The failure of Congress to make any basic change in the nature of our present tax denotes its acceptance of the concept that it taxes the interest which ceased by reason of death. The amendment actually adopted accepts this fundamental concept, approves it by declining to change it, and modifies its effect on charitable bequests by amending to cover that specific subject only.

Lomb v. Sugden, supra, was decided in the Circuit Court of Appeals for the Second Circuit on March 2, 1936, which was subsequent to the "legislative reversal" of Edwards v. Slocum insofar as it deals with charitable bequests. Lomb v. Sugden was heard before Judges Learned Hand, Swan and Augustus N. Hand; the opinion was written by Judge Augustus N. Hand. This was an appeal in a suit brought by the executor of the will of Carrie B. Lomb to recover an alleged overpayment of federal estate taxes. Mrs. Lomb, at the time of her death, owned 1500 shares of Bausch & Lomb Optical Company, and by her will bequeathed them as a part of her residuary estate to her husband, Carl F. Lomb, and appointed him executor. Prior to her death, she had entered into an agreement with all the other stockholders of the company, whereby none of them could sell their stock without first offering the shares to be sold to the others at $69.445 per share; if the other stockholders declined to purchase, the stock might be sold to outsiders; under the agreement, any stockholder could give away his stock to any of the other shareholders and, if he died without issue, might bequeath it to any of the other shareholders and might also bequeath 10% of his holdings to outsiders. (The opinion does not discuss the possibility that Mrs. Lomb might have bequeathed 10% of her holdings to outsiders; it is our thought that this phase of the problem was not mentioned, for the reason that Judge Hand based his decision upon the circumstances existing during the lifetime of Mrs. Lomb, and not those which came into being at her death.) If a stockholder left no issue and to the extent that he made no such bequests (to other shareholders or not exceeding 10% to outsiders) his executor must offer the stock at the limited price to the other stockholders; and in event of their failure to purchase, the executor might then sell the stock without any restriction. The fair

market value of the stock was $100.00 per share. The executor valued it in the estate tax return at $69.445 per share.

The Commissioner of Internal Revenue disregarded the limitation fixed in the agreement and assessed the shares at $100 each for estate tax purposes. The executor paid the deficiency thus imposed and brought this action to recover the payment. In discussing the problem presented, Judge Hand refers to Edwards v. Slocum, supra, and Knowlton v. Moore, supra, and observes that as was stated in those cases, the tax is on "not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death." Judge Hand said further:

> "Mrs. Lomb at the time of her death was restricted to a price of only $69.445 because she was obliged either to donate her stock to the other stockholders or to offer it to them at that low price. In either event that price was the most that she could obtain for her stock in the natural course of events."

Judge Hand's conclusion is expressed by him in the following words:

> "Because of the agreement, the decedent could not have secured a price greater than $69.445 at the time of her death. It is as of that time that the value of the stock must be determined. Then she could only give it or sell it to the other stockholders at the price fixed. Its value to the estate can be no greater than that with which the decedent parted. Edwards v. Slocum, 264 U. S. 61, 63."

As noted above, there were some circumstances under which at least 10% of Mrs. Lomb's stock could have been released at her death from the restrictive or option agree-

ment; Mrs. Lomb might have bequeathed it to an outsider who could immediately have sold it for $100,000 per share; but Judge Hand does not even discuss the possibilities as they existed under Mrs. Lomb's will or after her death; on the contrary, his opinion is directed entirely to the circumstances which existed during the lifetime of Mrs. Lomb. The Court of Appeals for the Second Circuit obviously interpreted Knowlton v. Moore and Edwards v. Slocum as meaning that the value for estate tax purposes must be determined as based upon the circumstances existing during the lifetime of Mrs. Lomb and terminated by her death.

In the case we present, neither Robert Land nor John Robert Land, during life, could have converted his interest in the partnership into cash except at a discount of one-third. Under the reasoning applied by the Court of Appeals for the Second Circuit in the Lomb case, the value for estate tax purposes should have been fixed at two-thirds of fair market value. The fact that the executor might have obtained full value for it is beside the point. To quote Judge Hand, "Its value to the estate can be no greater than that with which the decedent parted."

The Court of Appeals for the Fifth Circuit asserts that we have misinterpreted Edwards v. Slocum. Judge Wisdom, speaking for the Court, says:

> "Brief as is the instant of death, the court must pinpoint its valuation at this instant the moment of truth, when the ownership of the decedent ends and the ownership of the successors begins. It is a fallacy, therefore, to argue value before or after death on the notion that valuation must be determined by the value either of the interest that ceases or of the interest that begins. Instead, the valuation is determined by the interest that passes, and the

value of the interest before or after death is pertinent only as it serves to indicate the value at death."

This assertion by Judge Wisdom is in direct conflict with that of Judge Hand in Lomb v. Sugden. It is in direct conflict with the clear and direct pronouncements of this Court that the estate tax is imposed upon "the interest which ceased by reason of the death." Judge Wisdom's theory appears to contemplate determination of value as of an imaginary fragment of time intervening between life and death, not measured "by the value either of the interest that ceases or of the interest that begins." There is no such fragmentary period of time. The partnership interests with which we are here dealing belonged to the living partners right up to the moment of death. At the instant when death occurred, the ownership passed to the devisees of the decedent. The property must be valued for estate tax purposes either as it existed in the hands of the living partner up to and at the moment of death, or as it exists in the hands of the devisees at the moment after death. We are not able to comprehend a valuation attributable to any imaginary intervening fragment of time, conforming neither to the interest which ceased nor to that created by the death. According to Edwards v. Slocum as interpreted in Lomb v. Sugden, the value for estate tax purposes must be determined at the moment of death, but as based upon the value of the interest which then ceased to exist.

It is worthy of note that the Court of Appeals for the Second Circuit had decided Wilson v. Bowers, 57 F. 2d 682, in 1932, some four years prior to Lomb v. Sugden; the same three judges who heard and decided the Lomb case had also heard and decided Wilson v. Bowers. In the Wilson case, there was a restrictive price agreement which was not affected by death; the same restriction was

applicable after death as before; there, the Second Circuit held the restrictive agreement controlling, but there was no necessity for any reference to the principles announced in Knowlton v. Moore or Edwards v. Slocum, because death created no change in the restrictive agreement. Four years later, when Lomb v. Sugden came before the same court, it presented a situation before death differing from that which existed after death, which necessitated further analysis of the principles involved and a proper application of Knowlton v. Moore and Edwards v. Slocum. The Fifth Circuit, in our case, refers to Wilson v. Bowers and Lomb v. Sugden as if there were no distinction between them, and the Fifth Circuit completely disregards the concept of basing the estate tax on the interest which ceased by reason of the death.

The fact that the Tax Court recognizes and follows the principles announced in Lomb v. Sugden is illustrated in the case of Estate of James H. Mathews, 3 T. C. 525, which presents the reverse of our situation. In the Mathews case, there was no restriction during life, but there was a restrictive option which came into being at death; as based upon Lomb v. Sugden and Edwards v. Slocum, the Tax Court correctly held that the estate tax is measured by the value of the interest with which the decedent parted at death. The restrictive option created by will was held not to affect value for estate tax purposes. The same situation existed and was similarly adjudicated in Hoffman v. Commissioner, 2 T. C. 1160.

CONCLUSION.

The question presented is of substantial importance; in the proper determination of estate taxes, the application of the principles involved here will recur from time to time, and there should not exist a conflict between the

Courts of Appeals on the subject. The writ of certiorari here sought should be granted, in order that this Court may clarify the situation and remove the conflict.

Respectfully submitted.

JOHN E. ADAMS,
Attorney for Petitioner.

C. B. GILLMORE,
JOHN E. ADAMS, JR.,
Of Counsel.

APPENDIX A.

OPINION OF THE COURT OF APPEALS.

In the
United States Court of Appeals
For the Fifth Circuit.

No. 18958

United States of America,
Appellant,
versus
Charles M. Land, as Successor Executor of the Last Will and Testament of John Robert Land, Deceased,
Appellee.

No. 18959

United States of America,
Appellant,
versus
Charles M. Land, Ernest H. Land and Margaret L. Haney, as Executors of the Last Will and Testament of Robert Land, Deceased,
Appellees.

Appeals from the United States District Court for the Southern District of Alabama.

(May 16, 1962)

Before Rives and Wisdom, Circuit Judges, and Carswell, District Judge.

Wisdom, Circuit Judge: These cases pose a problem in the valuation, for federal estate tax purposes, of a partnership interest subject to a restrictive agreement limiting the sales price of the interest to two-thirds of its value in the event of its sale during the partner's lifetime. The district court agreed with the taxpayers that the restriction limited the valuation to two-thirds of the property's calculated net value. We reverse. A restriction on the value of a partnership interest that expires at the decedent's death cannot affect the valuation of the interest for estate tax purposes.

The decedents, John Robert Land and his father, Robert Land, were members of a family partnership, Land Brothers & Company, formed in 1939 to engage in the general merchandise business in Melvin, Alabama. The partnership agreement provided that if any member wished to withdraw from the partnership during his lifetime the other partners would have the option of purchasing his interest at two-thirds its calculated value. At the death of a partner, the surviving partners became entitled to purchase his interest at its full value; if they did not do so, the partnership would be dissolved and its assets liquidated and distributed. John Robert Land died January 5, 1955. His father died a few months later. In reporting the value of each decedent's partnership interest the executors reduced the fair market value by one-third on the theory that value is determined before death and that the restriction controlled the valuation for federal estate taxes. There is no dispute as to the value of the interests apart from the controversy over the effect of the restriction in the partnership agreement.

The taxpayers rely primarily on the Supreme Court's pronouncement in **Edwards v. Slocum**, 1924, 264 U. S. 61, 44 S. Ct. 293, 68 L. Ed. 564, that the object of an estate tax

is "not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death". This reliance is misplaced. This is another instance of the truth of Justice Holmes's observation that there is "danger [in] reasoning from generalizations unless you have the particulars which they embrace in mind".[1] As other courts have pointed out in[2] referring to **Edwards v. Slocum**, the Supreme Court described the estate tax as one on "the interest which ceases by reason of the death" simply to distinguish it from a succession tax, which is calculated and graduated on the individual portion of the estate each heir or legatee receives rather than on the aggregate property passing from the decedent. **Edwards v. Slocum** did not involve the valuation of property for estate taxes.[3]

The statute applicable here is the general provision, Section 2033 of the Internal Revenue Code of 1954. This provides that "the gross estate shall include the value of all property . . . to the extent of the interest therein of the decedent at the time of his death." The Regulations reiterate the truism that the tax is "an excise tax on the transfer of property at death and is not a tax on the prop-

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[1] Holmes, "Law in Science and Science in Law", 12 Harv. L. Rev. 443, 461 (1899).

[2] See Goodman v. Granger, 3 Cir., 1957, 243 F. 2d 264, 268, cert. denied, 355 U. S. 835; Christiernin v. Manning, D. C. N. J., 1956, 138 F. Supp. 923, 926.

[3] The question in Edwards v. Slocum was whether the estate could claim as a charitable deduction the full amount of the before-tax residue even though the residue (and therefore the amount received by the charity devisees) would necessarily be reduced by the payment of the estate taxes. The Court allowed the full deduction, but was later overruled by legislation. See Section 807 of the Internal Revenue Act of 1932. This deduction is a matter of legislative grace which could be varied as Congress saw fit, and should not be expected to dovetail with tests for valuation of property in the estate.

erty transferred." Treas. Reg. 20.2033-1 (a). It is, of course imperative that the tax be imposed on the **transfer** of the property in order to avoid the constitutional prohibition against unapportioned direct taxes. From this, it seems to us, it follows that the valuation of the estate should be made at the time of the transfer. The time of transfer is the time of death. Treas. Reg. 20.2031-1 (b). In **Knowlton v. Moore**, 1900, 178 U. S. 41, 56, 20 S. Ct. 747, 44 L. Ed. 969, the Supreme Court said, "tax laws of this nature in all countries rest in their essence upon the principle that death is the generating source from which the particular taxing power takes its being and that it is the power to transmit, or the transmission from the dead to the living, on which such taxes are more immediately rested." See **Shedd's Estate v. Commissioner**, 9 Cir., 1956, 237 F. 2d 345, 350, **cert. denied**, 352 U. S. 1024.

Brief as is the instant of death, the court must pinpoint its valuation at this instant—the moment of truth, when the ownership of the decedent ends and the ownership of the successors begins. It is a fallacy, therefore, to argue value before—or—after death on the notion that valuation must be determined by the value either of the interest that ceases or of the interest that begins. Instead, the valuation is determined by **the interest that passes**, and the value of the interest before or after death is pertinent only as it serves to indicate the value **at** death. In the usual case death brings no change in the value of property. It is only in the few cases where death alters value, as well as ownership, that it is necessary to determine whether the value at the time of death reflects the change caused by death, for example, loss of services of a valuable partner to a small business.

An examination of several instances where the value of a decedent's property differs after death from its value

during his life indicates that whether the subsequent value is increased or reduced, the valuation at death uniformly gives full effect to the change that accompanies the death. In **Goodman v. Granger**, 3 Cir., 1957, 243 F. 2d 264, **cert. denied**, 355 U. S. 835, the court was called on to evaluate three employment contracts carrying contingent benefits of $2,000 annually for fifteen years after termination of the employee's employment, provided that the employee did not engage in any competing business for a certain period of time and provided that his post-employment earnings from other work did not exceed a specified amount. The trial court held that the value of the contracts must be limited to the interest of the decedent during his life and that his interest could not be valued because of the contingencies. On appeal the Third Circuit reversed. It ruled that since the possibility of forfeiture was extinguished by the decedent's death the contract rights should be given their full value for estate tax purposes. In **May v. McGowan**, 2 Cir., 1952, 194 F. 2d 396, a father and son had organized a corporation which assumed a large debt owed by the father. Each agreed that he would not sell his stock without first offering it to the other at a specified price, and if the son should buy his father's stock the price was to be reduced by the amount of any portion of the debt still outstanding. At the death of either the other would become entitled as of right to purchase the stock at the same specified price. The father died while the debt still exceeded the price the son was to pay for his father's stock, and the question arose as to the valuation of the father's stock for estate taxes. Although the stock presumably must have had some value during the father's life, because of his right to hold it so long as he lived and to receive any dividends paid, the Court found that the stock was valueless for estate tax purposes since the son could acquire it under the agree-

ment for nothing once his father died. Similarly, when the value of an interest in a corporation or partnership depends in part on the decedent's ability, activity, or goodwill, the value for estate taxes will be reduced to reflect the loss of the decedent. **Newell v. Commissioner**, 7 Cir., 1933, 66 F. 2d 102; see Estate of Maddock, 1951, 16 T. C. 324. The same rule applies in the case of life insurance contracts. During the life of the insured the value of a policy is its cash surrender value. After death the beneficiary holds a ripened claim for the face value. See **Commissioner v. Chase Manhattan Bank**, 5 Cir., 1958, 259 F. 2d 231, **cert. denied**, 359 U. S. 913. Section 2042 expressly provides that the latter valuation shall be used in determining estate taxes.[4]

Underlying the determination in these instances that the valuation of property passing at death reflects the changes wrought by death is a basic economic fact: value looks ahead. To find the fair market value of a property interest at the decedent's death we put ourselves in the position of a potential purchaser of the interest at that time. Such a person would not be influenced in his calculations by past risks that had failed to materialize or by restrictions that had ended. Death tolls the bell for risks, contingencies, or restrictions which exist only during the life of the decedent. A potential buyer focuses on the value the property has in the present or will have in the future. He attributes full value to any right that vests or matures at death, and

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[4] The valuation of annuities further illustrates the practice of referring to its future value. In Mearkle's Estate v. Commissioner, 3 Cir., 1942, 129 F. 2d 386 the decedent owned an annuity payable to himself during his life, then to his wife for her life. The court valued the contract at the purchase price of an equivalent annuity contract for the life of the wife based on her life expectancy at the decedent's death, without reference to his life expectancy or their joint life expectancy. See also Christiernin v. Manning, D. C. N. J., 1956, 138 F. Supp. 923.

he reduces his valuation to account for any risk or deprivation that death brings into effect, such as the effect of the death on the brains of a small, close corporation. These are factors that would affect his enjoyment of the property should he purchase it, and on which he bases his valuation. The sense of the situation suggests that we follow suit.

It might be argued that the Regulations abandon this approach and look to the past rather than the future in certain cases. Section 20.2031-2 (h) provides that when stock is held subject to an option that is to take effect at death but leaves the decedent free to dispose of the property during his life, the option or contract price will not control the evaluation for estate tax purposes. See Estate of Giannini, 1943, 2 T. C. 1160, 1176-80, aff'd without discussion of this point, 9 Cir., 1945, 148 F. 2d 285, **cert. denied**, 326 U. S. 730. This rule is based, however, on an entirely different foundation: when a decedent retains complete freedom to prevent the property being subjected to a restriction or contingency his inaction constitutes a passive transfer of an interest in the property to the person who stands to benefit by the limitation on the value of the property passing to the decedent's heir or legatee.[5] The rule applies the same principle that underlies Sections 2038 and 2041, which include within a decedent's estate

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[5] In Goodman v. Granger, 3 Cir., 1957, 243 F. 2d 264, 269, *cert. denied*, 355 U. S. 835, the Court stated: "True, the right to these payments was forfeitable upon the occurrence of any of the specified contingencies. However, forfeiture as a result of the contingencies never occurred during Blum's lifetime, and any possibility of their occurrence was extinguished by his death. Gimbels has been making and the estate has been collecting the payments provided by the contracts. Valuation of the right to these payments must be determined as of the time of Blum's death when the limiting factor of the contingencies would no longer be considered. Death ripened the interest in the deferred payments into an absolute one, and death permitted the imposition of the tax measured by the value of that absolute interest in property."

property over which he held a power of disposition or appointment.[6] Under this analysis such a case does not present a problem of changing value; the interest simply is split and passes to different persons, but its total value is unaltered, and that is the value included in the estate.

The cases relied on by the appellees are not in point. They involve restrictions which not only were in effect during the decedent's life but were effective and enforcible on his death; **Wilson v. Bowers**, 2 Cir., 1932, 57 F. 2d 682; **Lomb v. Sugden**, 2 Cir., 1936, 82 F. 2d 166. See Mertens' Law of Federal Gift and Estate Taxation, § 9.08. Thus, in **Wilson v. Bowers** the Court emphasized the fact that there was a specifically enforcible contract giving the shareholders the right to purchase stock at a specified price upon the owner's intended disposal of the stock **or upon his death.** In **Lomb v. Sugden** the same court held a restriction conclusive of value where there was an enforcible agreement giving the decedent the power of disposal within a group. Other cases have distinguished between an enforcible option immediately exercisable at the will of the buyer, as in **Wilson v. Bowers**, and a mere right

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[6] In Chase National Bank v. United States, 1929, 278 U. S. 327, 335, 49 S. Ct. 129, 73 L. Ed. 405, the Supreme Court held the estate tax could properly be imposed on the transfer of the decedent's life insurance at his death, although the interest of the beneficiaries had vested before his death and the proceeds were paid to them by the insurance company rather than by the decedent. The Court stated: "A power in the decedent to surrender and cancel the policies, to pledge them as security for loans and the power to dispose of them, and their proceeds for his own benefit during his life which subjects them to the control of a bankruptcy court for the benefit of his creditors . . . and which may, under local law applicable to the parties here, subject them in part to the payment of his debts . . . is by no means the least substantial of the legal incidents of ownership, and its termination at his death so as to free the beneficiaries of the policy from the possibility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death. See also Saltonstall v. Saltonstall, 1929, 276 U. S. 260, 48 S. Ct. 225, 72 L. Ed. 565.

of first refusal. **Worchester County Trust Co. v. Commissioner**, 1 Cir., 1943, 134 F. 2d 578; **Michigan Trust Co. v. Commissioner**, 27 B. T. A. 556 (1933). Both in **Wilson v. Bowers** and in **Lomb v. Sugden** it was decisive that the maximum price realizable by the estate was the option price, because the optionees having the right to buy could and probably would buy at the reduced value—before or after death of the decedent. Not so here. Here the option to sell at the reduced price had expired, and there is no reason to assume that the executors would sell below the fair market value.

Even if the partnership interest should, as the appellees contend, be valued at the moment before the decedent's death, it would be improper to limit the valuation to two-thirds its value. Although the Supreme Court in **Helvering v. Salvage**, 1936, 297 U. S. 106, 56 S. Ct. 375, 80 L. Ed. 511 declared that an option held by a stranger limits the value of the property to its owner to the option price, that decision should not be extended to cases where the restriction is only an obligation to offer the property to the third person at a pre-arranged price **if** the owner should decide to sell. The reasoning behind the decision in **Helvering v. Salvage** is that if the value of the property rises above the option price the optionee will certainly exercise his option. But in the instant case the decedents had no such fear that they would lose their partnership interest as soon as it reached a certain value; the agreement reserved to each partner the right to hold his interest indefinitely, and the restriction on its sale price would become effective only if the partner chose to sell during his lifetime. Although the restriction would reduce the value of the interest somewhat, immediate saleability is certainly not the only attribute of value. The decedent's right to hold the interest and receive income from it, with the assurance that eventually the interest

would be redeemable at full value, would raise its current value well above the restricted price applicable during his life. While it would not be possible to determine the proper valuation exactly, an approximate estimate would be more acceptable than the arbitrary application of the two thirds price.

When John Robert Land and his father died, the possibility that either would withdraw from the partnership and surrender his interest at the two-thirds valuation was foreclosed. There was then no contract or option outstanding except in the partners to purchase at full value. Death sealed the fact that their interests would be purchased or redeemed at full value. The fair market value, therefore, of the partnership interest at the time of the death of the partner was its full value. That valuation is controlling for estate tax purposes.

The judgment is

Reversed.

A true copy

(Seal) Test: Edward W. Wadsworth,
Edward W. Wadsworth,

Clerk, U. S. Court of Appeals, Fifth Circuit, New Orleans, Louisiana.

Jul 9, 1962.